

BOOK REVIEW

TRUST AND TENSION WITHIN CORPORATIONS

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INTRODUCTION

Academic inquiry into the broader issues raised by corporate law has shown resilience within legal scholarship. Some observers may find this resilience surprising. Distinguished scholars have opined in recent decades that, as a field of intellectual effort, corporate law was moribund¹ or, only a bit less severely, that its underlying focus, substantive state corporate law, was itself a trivial endeavor.² The evident vigor of the field belies these assessments, however. Recent scholarship recognizes that disputed aspects of corporate law carry high normative and economic stakes. Highly publicized hostile takeovers in the 1980s demonstrated that control of large corporations is not immune to change facilitated by public financial markets. The takeover boom itself invigorated broad interest in the underlying structures of corporate governance defined by corporate law. Attention has focused more recently on the numerical predominance of institutional investors as shareholders in many large corporations and on institutions' enhanced willingness to exercise their shareholder governance rights or to threaten to do so.³ Corporate law scholarship, additionally, has historically been parochial in its scope, with most scholars confining their attention to domestic applications of their own nation's legal regime. The geographic range of corporate law scholarship has broadened in recent years to reflect the incontestable impact

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¹ Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 245 n.37 (1962).

² Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 551-61 (1990).

³ For an illuminating account of forces that shaped institutional ownership, see MARK J. ROE, *STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE* (1994).

of internationalized markets for goods, services, and equity capital, as well as the visibility of multinational corporate actors.⁴ Its intellectual range has expanded as well, reflecting in particular an influx of provocative insights based on the application of economic analysis to legal doctrine.

Unsurprisingly, recent scholarship about corporate law has engaged questions of much broader import than formal mechanics. Central to much of this scholarship is the broad and perennial question of how resolutely and how exclusively corporations should be managed to maximize shareholders' wealth. Much recent scholarship, reflecting developments in substantive corporate law and business practice, assesses the fit between private business corporations and their investors, managers, nonshareholder constituents, and the broader social environment.⁵ The proposition that directors and managers should make decisions so as to maximize shareholder wealth is a starting point for attack as well as defense.⁶ Likewise, recent scholarship examines the cultural and social circumstances that, in varied ways, tend to facilitate or discourage productive association among people, and between people and capital in cooperative ventures. The focus of much of this scholarship is broader than the conventional business corporation, addressing ongoing business relationships that are not structured as discrete firms, as well as a variety of relationships and organizations not established to pursue profit. The optimal role of law in this connection, as well as the form of law best suited, loom large as either explicit or implicit questions. Additionally, the thesis that trust is a constitutive element in many business relationships has been a focal point of recent scholarship. Of particular interest is the role of trust when parties enter a relationship in

⁴ See, e.g., Eric W. Orts, *The Legitimacy of Multinational Corporations*, in PROGRESSIVE CORPORATE LAW 247, 253 (Lawrence E. Mitchell ed., 1995), discussed *infra* at text accompanying note 135.

⁵ Only rarely are these questions engaged at any level of technical sophistication by scholars writing from an explicitly Marxist perspective. For a recent example, see H.J. Glasbeek, *More Direct Director Responsibility: Much Ado About . . . What?*, 25 CAN. BUS. L.J. 416 (1995).

⁶ Many dimensions of the debate are explored in Symposium, *The Corporate Stakeholder Debate: The Classical Theory and its Critics*, 43 U. TORONTO L.J. 297 (1993). On the corporate law front, in the midst of the 1980s takeover wave, several states adopted statutory provisions that expressly permitted directors to consider the interests of non-shareholder constituents. For a comprehensive treatment, see Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 16 (1992). Scholars have also examined the relationship between a corporation and holders of its debt securities, having identified its vulnerability to debtor opportunism. See, e.g., Victor Brudney, *Corporate Bondholders and Debtor Opportunism: In Bad Times and Good*, 105 HARV. L. REV. 1821 (1992); Steven L. Schwarcz, *Rethinking a Corporation's Obligations to Creditors*, 17 CARDOZO L. REV. 647 (1996).

pursuit of individual economic advantage. In any event, these are not the preoccupations of a presently or prospectively moribund field.

In this Essay I draw upon recent publications addressing the larger concerns of corporation law, including contributions to *Progressive Corporate Law*⁷ and several related books. Much of interest in these works falls outside the modest ambit of this Essay. Most of the Essay develops a central thesis, namely that in the varied relationships between people and all sorts of organizations, tension is inevitable between organizational efficacy and community among participants. This tension emerges predictably in the long run and frequently in the short run as well. Its inevitability in turn explains the salience of many points at issue among scholars who examine corporations and other organizations. An organization will predictably need to deploy tactics that enable it to further its objectives, whatever they might be and however they are determined, and will need to enforce strategies and mechanisms to assure participants' commitment to those objectives. But devices that aid the organization's efficacy may conflict with the interests of immediate participants in its work; immediate participants may value stability, continuity in relationships, sympathy with situations that compromise individuals' performance, and forgiveness of failure over harsh and destabilizing moves requisite to the organization's more abstract interests. A corollary of my central thesis is that many organizations that come to grief have resolved this tension unsatisfactorily. Tactics resolutely driven by an austere commitment to cost reduction in the service of a corporation's organizational interest in profitability may jeopardize relationships with employees and, for that matter, with customers and creditors, to the extent that the corporation cannot thrive. Even shareholders, the residual claimants on corporate profits, would suffer. To be sure, impediments to organizational change that protect existing relationships and participants can halt or delay change necessitated by shifts in the external environment.

To a surprising degree, much recent theoretical work on corporate law, or organizations more generally, tends to emphasize one strand in the tension, and to exclude or deemphasize the significance of the other. One wonders how discussion would proceed within pairs of theorists. Michael Jensen, for example, writes that "all organizations must evolve a way to change contracts that are no longer optimal."⁸ Jensen's influential 1993 article begins with a quotation from Joseph Schumpeter that situates capitalist firms within a "perennial gale of creative destruction," a theoretical construct in which the crea-

⁷ PROGRESSIVE CORPORATE LAW, *supra* note 4.

⁸ Michael C. Jensen, *The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems*, 48 J. FIN. 831, 849 (1993).

tion and destruction of structures are more significant than the administration of existing structures.⁹ Jensen's work also demonstrates that the relevant perspective to determine whether a contract is still optimal is that of the corporation's shareholders.¹⁰ In contrast, Francis Fukuyama's recent book, *Trust*, traces the economic strength of societies like Japan and Germany to widespread cultural habits that, translated into business practices, stabilize rather than destroy existing relationships and structures.¹¹ These habits endure through the adjustments required by economic downturns.¹² Such habits of trusting behavior also, writes Fukuyama, reduce the costs of transacting necessitated by formal contractual translation of expectations into entitlements; such habits may also facilitate the formation of less structured business networks.¹³

Additionally, the works under discussion differ in the significance and function they ascribe to law. Even in his discussion of the United States, Fukuyama for the most part treats law as a regrettable source of costs incurred to specify expectations and resolve disputes in societies whose stock of trust (and of social capital more generally) is relatively low.¹⁴ For other theorists, although law's role is more prominent, its

⁹ *Id.* at 833 (citing JOSEPH A. SCHUMPETER, *CAPITALISM, SOCIALISM, AND DEMOCRACY* 83 (1976)).

¹⁰ *Id.*

¹¹ FRANCIS FUKUYAMA, *TRUST: THE SOCIAL VIRTUES AND THE CREATION OF PROSPERITY* (1995).

¹² Despite the long economic downturn in Japan, few layoffs have occurred, illustrating the enduring normative force of the country's lifetime-employment system. Sheryl WuDunn, *When Lifetime Jobs Die Prematurely*, N.Y. TIMES, June 12, 1996, at D1, D6. In Europe, recent downsizings have relied on early retirements rather than layoffs of younger workers to reduce workforces. John Tagliabue, *In Europe, a Wave of Layoffs Stuns White-Collar Workers*, N.Y. TIMES, June 20, 1996, at A1, D8. Practices that stabilize employment have significant costs. Many European employers, confronting government restrictions that inhibited layoffs, in recent decades exhibited extreme caution about adding employees and investing in business expansion. *Id.* at D8. Unemployment rates are much higher in Western European nations than in the United States, and the relative rate of new job creation is lower. *Id.* Contemporary Japan combines both a low unemployment rate and relatively low worker productivity. The Japanese rate of unemployment is 3.4 percent, in contrast with 5.6 percent in the United States and more than 10 percent in much of Europe. WuDunn, *supra*, at D6. But Japanese worker productivity is 38 percent less than United States worker productivity, 23 percent less than Italian worker productivity and 10 percent less than German worker productivity. *Id.*

¹³ FUKUYAMA, *supra* note 11, at 152-54, 341-42.

¹⁴ Social capital encompasses features of social organizations that facilitate coordinated actions, such as trust, norms, and networks. ROBERT D. PUTNAM, *MAKING DEMOCRACY WORK: CIVIC TRADITIONS IN MODERN ITALY* 167 (1993). The presence of social capital makes it possible for groups to achieve ends not attainable in its absence because it reduces the effort and investment needed to accomplish the same work. See JAMES S. COLEMAN, *FOUNDATIONS OF SOCIAL THEORY* 302-07 (1990). "Social capital . . . is created when the relations among persons change in ways that facilitate action." *Id.* at 304. One form of social capital encompasses expectations of reciprocity, which implicates both the level of trustworthiness in the social environment and the extent of reciprocal obligations held. *Id.* at 306. In any event, social capital is not a unidimensional concept; different types of

nature and function are disputed. Central to the dispute is the characterization of corporate law as contractual, a view initially elaborated by Frank Easterbrook and Daniel Fischel in *The Economic Structure of Corporate Law*.¹⁵ Easterbrook and Fischel treat the corporation as a "nexus of contracts" among providers of inputs, including lenders, equity investors, and suppliers of labor and goods, which "focuses attention on the voluntary and adaptive nature of any corporation."¹⁶ Within this construct, corporate law itself is "a standard-form contract, supplying terms most venturers would have chosen but yielding to explicit terms in all but a few instances."¹⁷ Even mandatory rules of law (those not subject to specific agreement otherwise) can be characterized as "contractual" within this framework because such rules reflect the results of hypothetical bargains, that is, terms that parties would have agreed upon themselves, were they to bargain. Moreover, the relevant focus for analysis is the myriad contracts or transactions among participants in the corporation, not the organization itself. Easterbrook and Fischel intend their characterization to operate both as a description of corporate law as well as a normative principle with both explanatory and justificatory force. Interestingly, although a more recent and much lengthier work analyzes corporate law using contractualist techniques, its claims are more modest. In *Company Law: Theory, Structure, and Operation*, Brian Cheffins acknowledges the nexus of contracts characterization to be "at odds with the legal conceptualization of a company," but advocates its utility as an analytical exercise.¹⁸

associations and networks are likely to embody or generate social capital to different degrees. Robert D. Putnam, *Bowling Alone: America's Declining Social Capital*, 6 J. DEMOCRACY 65, 76 (1995).

¹⁵ FRANK H. EASTERBROOK & DANIEL E. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991).

¹⁶ *Id.* at 15.

¹⁷ *Id.*

¹⁸ BRIAN R. CHEFFINS, *COMPANY LAW: THEORY, STRUCTURE, AND OPERATION* 32 (forthcoming 1996). Professor Cheffin's book totals 714 pages, excluding any index (in page proofs), compared with the 352 pages of Easterbrook and Fischel's earlier publication.

A corporation's legal posture as an entity distinct from its shareholders is, simultaneously, the foundational consequence of corporate law and a limit on the explanatory completeness of contractualist accounts. *See id.* Incorporating a business enables its shareholders to benefit as owners and residual risk bearers without bearing fully the consequences of business failure. Shareholders who are no more than equity investors are not parties to the corporation's contracts nor do they act—tortiously or otherwise—on the corporation's behalf. That shareholders' risk of loss is limited to the amounts they promise to invest is consistent with ascribing a separate legal personality to the corporation. *Id.* It is not possible to fully replicate through contract the consequences of shareholders' limited liability. *But see* EASTERBROOK & FISCHEL, *supra* note 15, at 41 (stating that "[i]f limited liability were not the starting point in corporate law, firms would create it by contract."). To be sure, commitments created through contract could include provisions in which a creditor agrees to limit its claims, in the event of default, to the assets used to operate a business. This strategy is not available for liabilities created by many torts, and intra-corporate

Disagreement with the contractual characterization is an explicit or implicit starting point for several of the contributions to *Progressive Corporate Law*. Many of the contributors to the volume are less sanguine than are the contractualists about the efficacy of constraints—apart from mandatory legal rules—on opportunistic behavior. Contractualist treatments of corporate law, additionally, tend to disallow any independent significance for organizational structures and hierarchies, a disregard that is the focus of recent criticisms of contractualism.¹⁹ A further point of departure is the central role that several contributors to *Progressive Corporate Law* ascribe to trust as a guiding normative principle that complements or even competes with contract. The contributors diverge, however, in the relationships they examine. Some emphasize that trust and legal doctrines geared to encourage or protect it occupy dominant roles in relationships between shareholders and directors or managers, while others focus on the role of trust in relationships between corporations and their rank-and-file employees.

I

VARIED VIGNETTES OF TENSION

Tension between the demands of organizational efficacy and community among the organization's current participants is universal, manifesting itself in organizations with disparate purposes and governance structures. My examples illustrate the tension in disparate organizational settings, toward the end of demonstrating the universality of this tension. In business corporations, the tension often manifests itself in connection with decisions by directors or senior management that advantage or disadvantage the interests of shareholders over the interests of nonshareholder constituents. The tension also appears in other sorts of private organizations, including ones that lack parties who have legally-defined entitlements of ownership comparable to those of shareholders. My initial example comes from the world of higher education; my second example, set forth with greater elaboration, draws on incidents in the history of religion;

rate commitments to indemnify or insure equity investors against loss do not relieve them of underlying liability on claims made by third parties. The history of the joint stock company in Britain is illustrative. Prior to Parliament's enactment in 1855 of a general incorporation statute, joint stock companies—many of them publicly-traded by the mid 19th century—used a variety of contractual devices to confer limited liability on equity investors. Uncertainties about the legal efficacy of the joint stock structure led to general incorporation legislation and to an almost six-fold increase in the number of companies formed. See CHEFFINS, *supra*, at 40-41, 250.

¹⁹ See, e.g., GUNTHER TEUBNER, *LAW AS AN AUTOPOIETIC SYSTEM* (Zenon Bankowski ed. & Anne Bankowska & Ruth Adler trans., 1993), discussed *infra* at text accompanying note 109, and Robert Flannigan, *The Economic Structure of the Firm*, 33 OSGOODE HALL L.J. 105, 149 (1995), discussed *infra* at text accompanying notes 110-12.

and my final example focuses on the currently popular exercise of downsizing in large business corporations.

A. "Niceness creeping . . . like kudzu" ²⁰

The perils of undue emphasis on community are obviously present in profit-seeking business firms that operate in competitive markets. In such markets, a high-cost producer may not survive, especially if its products do not deliver such superior value that customers will pay a higher price. If customers defect and are not replaced, earnings will drop. In any event, a high-cost producer may have difficulty attracting or retaining equity investors. Some not-for-profit organizations, in contrast, are blessed to operate in environments in which competitive forces operate only slowly and indirectly. The not-for-profit setting also illustrates that the tension between efficacy and community is not necessarily a consequence of distance between an organization's owners and its managers. Much theoretical work in corporate law addresses the separation between equity ownership and operational control in public companies described by Berle and Means in 1933.²¹ The not-for-profit setting offers a useful contrast, especially when one focuses on organizations created to serve charitable, religious, or educational objectives.²² Ownership is an elusive concept in many not-for-profit organizations because members of not-for-profit corporations do not enjoy economic consequences of ownership that are analogous to stockholders' entitlements in a for-profit business corporation. Nor does the law draw an analogy between the governance rights of donors to not-for-profit corporations and the voting rights of shareholders. Not-for-profit corporations may not distribute earnings to members and, indeed, are legally free to define membership as the organizers see fit. As a consequence, quantifiable objectives for the organization comparable to profit maximization may be more elusive or contested than in the typical business corporation. Indeed, claims of "ownership" made by not-for-profit constituents are metaphorical yet often persuasive, as we shall shortly see.

Consider in this light the liberal arts college scrutinized by P.F. Kluge in *Alma Mater*.²³ At Kenyon College, writes alumnus Kluge, the interests of the community—"warm and supportive, friendly and forgiving . . . override the harsher and more abstract interests of the college."²⁴ What facts support this conclusion? Students have little risk

²⁰ P.F. KLUGE, *ALMA MATER: A COLLEGE HOMECOMING* 250 (1995).

²¹ See ADOLPH A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 119-20 (1933).

²² This focus excludes from discussion not-for-profits created to serve only the interests of their members.

²³ KLUGE, *supra* note 20.

²⁴ *Id.* at 219.

of ever receiving a low grade; most coast through school without confronting significant intellectual challenges. About ninety percent of the faculty receive tenure and are promoted; collegial assessments of teaching quality are generous, while expectations for scholarship are not rigorously defined. Many members of the faculty do not publish thereafter; some are suspicious of colleagues who publish actively. The college's administration, writes Kluge, "seems to lack, not just the money, but the heart to risk unpopularity."²⁵ As Kluge himself concedes, his vision may be tainted by his recollections of the college as he remembers it as a student. The most critical assessments of the college, however, appear not in the author's own statements, but in those attributed to current faculty and administrators. Moreover, Kluge and his quoted sources may have a bleaker assessment than circumstances warrant; in particular, they may disregard the positive promise that a capacity for self-criticism often represents.

The story, in its simplest terms, suggests two basic morals as well as further questions. An organization's community-enhancing traits may produce slack, and in turn the organization may drift from its purpose. Participants within the organization who perceive the drift may be unable to arrest it and, as a result, become less than proud of their continued association with the organization. One wonders, then, whether drift is inevitable in all not-for-profit organizations, given the absence of owner-imposed constraints. Surely, though, some not-for-profit organizations succeed over time in fulfilling their purposes, as assessed by external as well as internal observers. What factors explain organizations that succeed while others drift? In the absence of institutionally—and legally—acknowledged ownership rights, a determining factor may be the degree of participants' commitment to the institution's purpose. One might consider whether direct participants in the institution's work have so deeply internalized its values that their individual sense of worth is committed to the institution's fidelity to its purpose.²⁶ Moreover, as long as participants continue to identify with the institution, their relationship with it may endure despite occasional disappointments and challenges to their trust in the institution.²⁷

A complicating factor is that facets of many institutions evolve over time. In the collegiate world described by Kluge, educational programs change, as does student quality. Single-sex institutions become co-educational. Fraternal organizations wax and wane in popu-

²⁵ *Id.* at 250.

²⁶ William R. Cotter, *Why Tenure Works*, *ACADEME*, Jan.-Feb. 1996, at 26, 28.

²⁷ Roy J. Lewicki & Barbara Benedict Bunker, *Developing and Maintaining Trust in Work Relationships*, in *TRUST IN ORGANIZATIONS: FRONTIERS OF THEORY AND RESEARCH* 114, 127-28 (Roderick M. Kramer & Tom R. Tyler eds., 1996).

larity. When does change represent drift, and when is it better characterized as an adaptation to the institution's external environment or as an enhancement of an incident of institutional quality?²⁸ In organizations that lack owners, disputes over characterization often have a murky quality. Formally, the institution's governance process controls its evolution. Assertions of "ownership" in academic institutions—by tenured faculty, by alumni, by students—often appear in response to contested changes within the institution. In this context, an assertion of ownership could be understood as a claim that the institution's formal organs of governance—its faculty, or trustees, or administrative officers—ought to heed the opinions of those whose interests are tied to the institution, perhaps in whose lives it has played a central or critical role. If such claims are persuasive, the institution's informal internal understandings complement its formal governance mechanisms for decisionmaking. An assertion of ownership may also, of course, threaten retaliation in economic form, for example, by disappointed alumni who withhold or cease making contributions. Any analogy to shareownership in a business corporation is incomplete, however. Unlike a shareholder, the disgruntled alumnus has no counterpart to selling stock that has underperformed, because personal history itself cannot be jettisoned the way financial investments can. This fact must be a source of considerable frustration to some.²⁹

- B. "[E]very new influence [was] a hostile one, in a grasping and acquisitive society which had as its characteristic quality a keen appreciation of the main chance."³⁰

Incidents in the history of religious orders, in particular of Christian monastic orders, afford more complex illustrations of the tension between the interests of organizational efficacy and participants' community, and of the relationship between that tension and the institution's capacity to respond to changes in external circumstances. That the tension frequently manifests itself in this context is not surprising. One scholar characterizes the history of religious orders as inevitably cyclical, initiated by a charismatic founder with enthusiastic adherents among religious virtuosi, to be followed by a decline in enthusiasm in the next generation of members, followed next by perceptible declines in morale and adherence to the founder's vision.³¹ Lax prac-

²⁸ How best to characterize a controversial development is often at issue in institutional conflicts with alumni. For a recent example, see David Greenberg, *The Alumni Are Coming! The Alumni Are Coming!* LINGUA FRANCA, Jan.-Feb. 1996, at 51, 53-54.

²⁹ See *id.*

³⁰ DAVID KNOWLES, *BARE RUINED CHOIRS: THE DISSOLUTION OF THE ENGLISH MONASTERIES* 7 (1976).

³¹ See PATRICIA WITTEBERG, *THE RISE AND DECLINE OF CATHOLIC RELIGIOUS ORDERS: A SOCIAL MOVEMENT PERSPECTIVE* 177-202 (1994).

tice and decadence lead to a decline in reputation, and in some cases to revival under the leadership of reformers.³² Moreover, this pattern repeats itself often because, upon the founder's death, commitment founded on personal ties to a charismatic leader shifts to adherence to an ideology defined in more abstract and depersonalized terms. Ideology institutionalized into routine rules and tradition may eventually supplant ideological commitment itself. And later-generation members may lack the commitment necessary to perceive their own indulgence in secular concerns and comforts.

The history of monasticism is replete with illustrations of organizational drift from the founder's vision of ascetic spirituality. Martin Luther made this point to great effect! Moreover, some religious orders internally replicated the consequences of secular hierarchies based on social class and wealth. In thirteenth century Benedictine monasteries, according to a Franciscan chronicler, the abbots ate meat with outside visitors while the ordinary monks ate vegetables.³³ And in the Carmelites, the order reformed by St. Teresa of Avila in the sixteenth century, women of substance who joined the order continued to be addressed by secular honorific titles; many nuns of high social rank, additionally, entered the order accompanied by their retinue of servants and slaves.³⁴

Some founding visions, moreover, by their nature assured that tension would emerge, prompted by organizational changes that represented drift to some observers and necessary evolution to others. The history of the Franciscan order is a leading example. Proceeding in the thirteenth century as a religious reformer, St. Francis of Assisi had a magnificently simple message requiring a degree of asceticism and commitment that made literal observance difficult for the less heroic.³⁵ Francis's expression of his vision in his Rule became the founding charter for his order, an order periodically rift between demands that it practice the absolute poverty required by Francis himself and its need to accumulate wealth sufficient to attract and retain adherents to permit the order's survival.³⁶ The order, additionally, attracted some adherents whose zealotry troubled other members.³⁷ The order was, in short, frequently in conflict over its fidelity to Francis's founding vision.

³² *Id.* at 196-205.

³³ DUANE J. OSHEIM, *A TUSCAN MONASTERY AND ITS SOCIAL WORLD: SAN MICHELE OF GUAMO (1156-1348)* 187 (1989).

³⁴ See Jodi Bilinkoff, *Teresa of Jesus and Carmelite Reform*, in *RELIGIOUS ORDERS OF THE CATHOLIC REFORMATION* 165, 167 (Richard DeMolen ed., 1994).

³⁵ See Elisabeth G. Gleason, *The Capuchin Order in the Sixteenth Century*, in *RELIGIOUS ORDERS OF THE CATHOLIC REFORMATION*, *supra* note 34, at 31, 35.

³⁶ *Id.* at 31-32.

³⁷ *Id.*

Finally, the history of monasticism in England illustrates the relationship between a hostile external environment and the tension between organizational efficacy and community. The relative ease with which King Henry VIII succeeded in dissolving English monasteries so as to expropriate their property and augment the monarchy's revenues³⁸ can be explained, in part, by the compromised quality of much of English monasticism at the time. In a newly-mercantile era in which the secular sovereign loomed large, monasteries lost the primacy as cultural and economic institutions that characterized their medieval place in the social order. At the same time, their visible religiosity had waned, as had any general commitment to ascetic self-sacrifice.³⁹ Many monastics, in David Knowles's assessment, lacked any anchor beyond a vestigial sense of spiritual realities to counter the new sense of loyalty to their secular sovereign.⁴⁰ Internally compromised orders that inspired little external respect were, when confronted by Henry's demands, soon to accede and crumble.⁴¹ Knowles, himself a monk, concludes in his narrative of dissolution that the message for monks is that "only in fidelity to the Rule can a monk or monastery find security."⁴²

These historical vignettes illustrate that institutions adrift from their defining purpose are often fragile. Knowles's emphasis on the security to be found in fidelity to the Rule is susceptible of several interpretations, each instructive. To the extent participants have internalized the institution's goals as their own, drift is less likely and evolution in the organization's mission is in retrospect less likely to appear biased by self-indulging interests. In a religious context, moreover, the "security" that ultimately matters is distinct from temporal and material concerns. Finally, as an authoritative written text, the Rule itself defines the institution; members' need to interpret the text and their concern that the interpretation be accurate enhance commitment to the institution and create bonds of community.⁴³

³⁸ Henry established the aptly-named Court of Augmentations in 1536 to control litigation and administration connected with property coming to the crown as a consequence of dissolution. See KNOWLES, *supra* note 30, at 286. Knowles characterizes Henry's project as an early example of nationalization. *Id.*

³⁹ *Id.* at 309-10.

⁴⁰ *Id.* at 7.

⁴¹ *Id.* at 83.

⁴² *Id.* at 320.

⁴³ For a similar argument founded in the Jewish legal tradition, see Robert M. Cover, *The Supreme Court, 1982 Term—Forward: Nomos and Narrative*, 97 HARV. L. REV. 4, 40-41 (1983). Language itself, viewed as a rule-governed activity, could be seen as a form of private law making, and thus as a constitutive factor in the community among users of the language. See Walter O. Weyrauch & Maureen A. Bell, *Autonomous Lawmaking: The Case of the "Gypsies"*, 103 YALE L.J. 323, 380-82 (1993).

Moreover, in some religious traditions the nature of the text itself resists abstraction and depersonalization, instead helping to create immediate and personal values among

C. "Another year, another downsizing . . ."⁴⁴

In recent years, many profitable public corporations in the United States restructured or "downsized" themselves by jettisoning large numbers of employees. Some corporations repeatedly downsize, to the applause of financial analysts when, predictably, the trading price of the corporation's shares rises on the stock exchange after a public announcement of downsizing plans.⁴⁵ A recent (and drastic) example is AT&T's announcement at the end of 1995 that it planned to downsize forthwith by 40,000 employees. Its stock rose \$2.625 to \$67.375, an increase of 4%.⁴⁶ Investors presumably respond positively, and buy shares, in the belief that downsizing reduces payroll costs, freeing revenue for dividends or, more often, for internal reinvestment into segments of the corporation's business that promise future growth.⁴⁷ Downsizing trims unnecessarily large workforces, which by reducing a corporation's costs enables it to compete more effectively. Firms previously insulated by regulatory structures from full price competition would be plausible settings in which efficiency gains may be realized through downsizing. What's more, employees who survive one downsizing may work harder because they fear that otherwise they may be the next to go.

Downsizing does not always represent an uncompromised victory for organizational efficacy (and increased shareholder value) over drift, slack, and complacency, because it may compromise the post-downsized corporation's ability to operate successfully. One recent study of downsizing over the past five years concluded that fewer than half of the downsizing firms subsequently increased profits; only a third reported higher productivity.⁴⁸ Another study found that downsized firms outperformed the S&P 500 only slightly during the six

adherents. The history of Hasidism is illustrative. Many Hasidic groups flourished under charismatic leaders, some degenerating after the leader's death. The notable exception is the "dead Hasidim," a thriving group whose founder, Rabbi Nahman of Bratzlav, instructed his followers through parables. Published posthumously in book form, Rabbi Nahman's parables have prophetic and poetic qualities and can be read on many levels; their study constitutes his adherents' central activity. See *THE ENCYCLOPEDIA OF HASIDISM* 335-38 (Tzvi M. Rabinowicz ed., 1996). This text, in practice, has regenerative properties because its nature is inimical to abstraction. *Id.*

⁴⁴ *Two Cheers for Loyalty*, *THE ECONOMIST*, Jan. 6, 1996, at 49.

⁴⁵ Some commentators argue that this predictable reaction is hard to explain when the same corporation restructures repeatedly because recurrent restructuring suggests that past earnings have been overstated. For example, AT&T incurred \$14.2 billion in restructuring charges over the past decade, an amount that exceeds its total reported net income of \$10.3 billion. See Randall Smith & Steven Lipin, *Are Companies Using Restructuring Costs to Fudge the Figures?*, *WALL ST. J.*, Jan. 30, 1996, at A1.

⁴⁶ *Id.*

⁴⁷ See, e.g., *id.* (discussing how companies use restructuring to make earnings appear larger).

⁴⁸ See FREDERICK F. REICHHELD, *THE LOYALTY EFFECT* 95 (1996).

months following the announcement of restructuring, and then underperformed the index by twenty-four percent over the next three years.⁴⁹ To be sure, had the firms not downsized, the results might have been much worse!

Business commentators suggest that downsizing has negative consequences of its own, even if it averts even worse performance for some corporations. The underlying concern is whether, in post-downsized corporations, destruction will engender sufficient creation to offset its negative effects. Widespread downsizing is said to have produced a "layoff survivor syndrome" in most Fortune 500 companies, "in which mistrust and anxiety replace feelings of loyalty and security."⁵⁰ Survivors of a downsizing may feel guilt if they perceive their own work commitment and quality as comparable to that of victims of the downsizing. Survivors also assume the workloads of their erstwhile colleagues and, reportedly, in many cases focus their energies on planning their own career moves.⁵¹ Such an allocation of energy does not bode well for productivity or for the corporation's ability to retain customers allied to mobile employees. Customer allegiance to specific employees is obviously not uniform across industries, but in some service-based industries customer loyalty may be more intensely focused on employees than on the firms employing them.⁵² Moreover, it is unsurprising that downsizing has such consequences for specific corporations even in the face of aggregate economic data establishing that, in recent years, more than enough new jobs have been created to absorb all laid-off workers in addition to new entrants to the work force.⁵³ Widespread apprehension among employees is understandable; an estimated one-third of laid-off full-time workers who find new jobs take pay cuts of twenty percent or more,⁵⁴ while only thirty-five percent end up in equally or better paying jobs.⁵⁵ In any event, aggregate employment data do not address the consequences of downsizing for any corporation in particular.

The phenomenon of downsizing in profitable corporations is a useful context in which to examine the normative presuppositions and practical implications of recent scholarship in corporate law, even though some theorists may not have anticipated the emergence of this

⁴⁹ *Id.*

⁵⁰ *Id.* at 93.

⁵¹ *Id.* at 95.

⁵² Such allegiance appears to be especially strong in the retail stockbrokerage industry because customers who "defect" from brokerage firms, as often as not, follow their individual broker to her new employer. *See id.* at 98.

⁵³ Louis Uchitelle & N.R. Kleinfeld, *On the Battlefields of Business, Millions of Casualties*, N.Y. TIMES, Mar. 3, 1996, at 1, 14.

⁵⁴ Economic Report of the President 26 (Feb. 1996).

⁵⁵ Uchitelle & Kleinfeld, *supra* note 53, at 26.

specific phenomenon. In the “nexus of contracts” corporation, the relevant question is whether the downsizing breaches a contract between the corporation and its employees. Parties are held to their bargains, which consist of explicit agreements and allocations of discretion created by the corporate form itself. Easterbrook and Fischel write that their approach does not demarcate sharply between employees and equity investors, since employees have invested human capital just as equity investors have contracted to supply capital.⁵⁶ Instead, this approach asks what entitlements have been created.⁵⁷ If employees have not bargained for a protected entitlement, “they ought not grumble if they are held to their bargains when business goes bad.”⁵⁸ Current downsizings present a harder case, though.

What of corporations that downsize despite business success in the prospect of doing better, by some measure, in the future? Employees, however much they grumble, either have or have not obtained explicit contractual protection against termination in such circumstances. Although academic literature in labor economics is replete with references to “implicit” contracts reflecting expectations grounded in past practice,⁵⁹ “implicit” contracts by themselves do not provide legally enforceable protection to employees. Implicit contracts do not supersede the employer’s managerial discretion to shrink its workforce. To survivors as well as victims of downsizing, the message from the “nexus of contracts” view is that only the foolish fail to pay close attention to their individual entitlements in relationship to any employer. This message is especially likely to be internalized by members of senior management who would have the incentive to bargain for contractual provisions that mitigate their individual risk of economic loss if they lose control of the corporation either to creditors in bankruptcy or to an acquirer in a takeover, should poor results follow a downsizing or another strategic move. In the absence of comparable protection, clever employees would, to the extent feasible, seek to develop transportable skills rather than invest themselves in efforts likely to be valued only by their current employer.⁶⁰

⁵⁶ See EASTERBROOK & FISCHEL, *supra* note 15, at 37.

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ See, e.g., Marleen A. O’Connor, *Promoting Economic Justice in Plant Closings: Exploring the Fiduciary/Contract Law Distinction to Enforce Implicit Employment Agreements*, in PROGRESSIVE CORPORATE LAW, *supra* note 4, at 219, 219. An implicit contract does not necessarily yield a legally enforceable implied contract. Implied-in-fact contracts reflect unarticulated but actual bargains; implicit contracts, in contrast, include employee expectations that the employer has not acknowledged as obligations.

⁶⁰ “They’re acting like independent contractors. And they’re more suspicious of management” reports a manager of employees who survived downsizing in a major bank. N.R. Kleinfeld, *The Company as Family, No More*, N.Y. TIMES, Mar. 4, 1996, at A1, A12.

David Millon's contribution to *Progressive Corporate Law* identifies a number of intellectual and practical difficulties with communitarian alternatives to the contractualized treatment of the corporation, which in turn illustrate a major limit on the persuasiveness of the "nexus of contracts" as a normative vision.⁶¹ Millon describes a "communitarian turn" in corporate legal theory, which unifies theorists who urge greater attention to ameliorating harsh consequences for a corporation's nonshareholder constituents.⁶² Although Millon's specific transactional focus is the hostile takeover, his analysis of the communitarian turn embraces its implications for downsizing as well. First, Millon is critical of multifiduciary models that expand the classes of beneficiaries to whom directors owe fiduciary duties beyond shareholders by obliging directors to act with loyalty to the interests of nonshareholder constituents.⁶³ Millon observes that multifiduciary models tend not to articulate any concrete content for the augmented duty or to specify any point at which shareholders' interests would trump those of nonshareholder constituents.⁶⁴ Additionally, the models are insensitive to the possibility of conflict among different types of nonshareholder constituents, such as creditors and employees.⁶⁵ Second, Millon critiques communitarian models that adopt more contractualist approaches.⁶⁶ These interstitial models attempt to identify gaps in explicit contractual provisions that might be occupied by implied contractual terms that protect the interests of nonshareholder constituents.⁶⁷ Like the multifiduciary models, approaches grounded in implied contract point to a content for the implied term that is indeterminate.⁶⁸ In application, models grounded in implied contract should approximate the results to which the parties would have bargained, which would reflect the parties' relative advantages and disadvantages in bargaining.⁶⁹ In the absence of an actual bargain, it is difficult to be confident about its content. Moreover, the bargain might well further advantage the party who entered the bargaining process with greater resources.⁷⁰

An even larger difficulty, in Millon's assessment, is that neither form of communitarianism overcomes the precontractual structuring

⁶¹ David Millon, *Communitarianism in Corporate Law*, in *PROGRESSIVE CORPORATE LAW*, *supra* note 4, at 1, 1.

⁶² *Id.*

⁶³ *Id.* at 11-16.

⁶⁴ *Id.* at 13.

⁶⁵ *Id.* at 14.

⁶⁶ *Id.* at 16-22.

⁶⁷ *Id.* at 16-19.

⁶⁸ *Id.* at 19.

⁶⁹ *Id.* at 20-21.

⁷⁰ *Id.*

of entitlements intrinsic to corporate law.⁷¹ Doctrines like employment-at-will and the exclusive assignment of voting rights to shareholders define important aspects of parties' relationships, but are not themselves the product of agreement. To be sure, these specifications of entitlement may be changed by agreement, but the burden of negotiating such a change is significant and typically falls on nonshareholders.⁷² Actual ability to bargain around a precontractual specification is, of course, a function of bargaining strength, skill, and intensity of relative desire to change the specification of entitlements. Bargaining itself consumes time and resources. As applied to the downsizing phenomenon, Millon's argument suggests inquiry into the circumstances under which employees do in fact bargain for and obtain either job tenure or attractive severance packages. If such bargains occur only rarely outside the context of contracts with senior management, what obstacles impede them for other cohorts of employees?

Consider in contrast the implications of grounding corporate structure in a pervasive norm of trust. Explicit specification of entitlements, and bargaining to arrange precontractual specifications, would diminish in importance and be superseded in many long-term relationships by a norm of reciprocity. Such a norm might well lack definition in all particulars, but it would operate within relationships to protect the expectation that one's efforts will in some fashion be rewarded over time.⁷³ The effect of the norm of reciprocity would dwindle, though, if one party departed from the norm and was not forgiven by the other party.⁷⁴ A profitable corporation's decision to

⁷¹ *Id.*

⁷² *Id.* at 21-22.

⁷³ See *supra* note 14 and accompanying text.

⁷⁴ Within close-knit groups, norms that enable people to achieve cooperative outcomes can emerge independent of formal legal rules or institutions. See ROBERT C. ELLICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* 167, 177-78 (1991). Ellickson's field study examines the development and enforcement of "norms of neighborliness" among cattle ranchers and land owners in Shasta County, California. *Id.* at 167. Ellickson hypothesizes that members of a close-knit group develop and maintain norms whose content maximizes the aggregate welfare of group members in their ordinary relationships with each other. *Id.* at 167. For a group to succeed in so doing or, alternatively, for a group to be defined as "close-knit," informal power must be broadly dispersed among group members and relevant information must circulate easily within the group. *Id.* at 177-78.

A corollary is that enterprises operating wholly beyond the law will not survive unless their operators and customers are highly trustworthy (or, perhaps, unless the enterprise can pose extremely credible threats of retaliation against those who offend it). Illegal bookies, for example, must be scrupulously honest and trustworthy; "the reliability of the [betting] transaction and the trustworthiness of the parties are necessary elements for this crisis-prone (or crisis-ridden) financial game to be played." Eugene J. Webb, *Trust and Crisis*, in *TRUST IN ORGANIZATIONS: FRONTIERS OF THEORY AND RESEARCH*, *supra* note 27, at 288, 289.

downsize could contravene employees' expectations that their past efforts would result in continued employment, if employees had been encouraged to develop such an expectation. Francis Fukuyama writes of the Japanese *nenko* tradition of lifetime employment that:

[a] system based on reciprocal moral obligation . . . needs to have a high degree of trust within the society in the first place. A firm could easily exploit workers . . . just as workers could become free riders. That neither happens to a noticeable extent in Japan is testimony to the fact that each side has a high degree of confidence that the other will live up to its end of the bargain.⁷⁵

More generally, the norm of reciprocity described by Fukuyama is a unifying force that coalesces owners, managers, and non-management employees; in contrast, downsizing a profitable corporation reflects a splintering force that anticipates (and encourages) self-protective behavior.

Fukuyama's account of the norm of reciprocity leaves much unexplained. Japan, like the United States, is not isolated from world markets and competitively-driven changes in business practice. The trust-based theory provides a normative basis for critiquing phenomena like downsizing, but by itself the theory does not predict how robust trust-grounded norms will be in the face of a dynamic external environment. Additionally, Fukuyama's account does not explore whether formal legal doctrine and institutions might facilitate or undergird the emergence of trusting behavior.⁷⁶ Marleen O'Connor's

⁷⁵ FUKUYAMA, *supra* note 11, at 192.

⁷⁶ Fukuyama draws comparisons between Japan and Germany that acknowledge the greater codification in law of German institutions that embody norms of reciprocity between labor and management. *See id.* at 218. More important in his account, though, are communal institutions that shape distinctive workplace relationships in Germany. *Id.* at 219, 243. Fukuyama also compares Germany to the United States, noting that the strong distrust of concentrated economic power in the United States led to antitrust legislation that dismantled monopolies, while German law facilitated the creation of cartels. *Id.* at 214-15. *But cf.* Curtis J. Milhaupt, *A Relational Theory of Japanese Corporate Governance: Contract, Culture, and the Rule of Law*, 37 HARV. INT'L L.J. 3 (1996) (ascribing considerable significance to the role of legal rules and institutions in the evolution of Japanese corporate practices and predicting that their influence will increase over time).

Additional dimensions of these contrasts stem from divergent patterns of corporate ownership, which are not explored in Fukuyama's book. In large German corporations, large banks hold significant blocks of stock. *See ROE, supra* note 3, at 171-77. Large Japanese corporations typically belong to a group of financial intermediaries and industrial firms linked by cross-shareholdings. *Id.* at 177-78. In contrast, diffusion typifies shareownership of large corporations in the United States, as does a more prominent role for public financial markets in allocations of capital. *Id.* at 4. As a consequence, strong financial intermediaries do not counterbalance management in large corporations in the United States. *Id.* at 5. A recent study, however, concluded that corporations in Germany and Japan use physical capital two-thirds as efficiently as do counterparts in the United States, which in turn helps to explain higher savings rates in Germany and Japan. G. Pascal Zachary, *U.S. Savings Worries May Be Overdone: Study Hints Efficient Asset Use Makes Up for Gaps*, WALL ST. J., June 7, 1996, at B7A. Differences among ownership structures and

contribution to *Progressive Corporate Law* advocates a change in current corporate law that is explicitly grounded in the proposition that formal law should nurture and protect trust.⁷⁷ O'Connor argues that corporate directors should be subject to a fiduciary duty to employees that would require directors to mitigate the severe impact on workers of fundamental corporate changes.⁷⁸ O'Connor's argument is that workers, by implicit agreement, defer compensation into the later stages of their careers.⁷⁹ If a corporate employer is free to close plants and lay off employees when doing so best serves directors' perceptions of the shareholders' interests, employees lose the deferred late-stage compensation to which their implied agreement entitles them.⁸⁰ Workers thus should be compensated for the loss of late-stage compensation.⁸¹ The technical difficulty with this theory, as David Millon points out, is that such implicit agreements are subject to override by express contract, and O'Connor's account does not treat the employees' entitlement as immune to express contract or as nonwaivable or immutable.⁸² Nor does O'Connor's argument explore the impact of the directors' duty to employees when the corporation prospers. If directors have profit to distribute, must they treat employees' implicit entitlements as comparable to those of shareholders?

O'Connor's broader point, like Fukuyama's, is the significance of reciprocity in economic relationships. To encourage explicit contracting in order to specify expectations reduces "cooperative efforts to improve productivity and product quality."⁸³ Workers who are encouraged to calculate their every unit of effort are not motivated to invest more of themselves in the absence of closely calibrated inducements.⁸⁴ And could the inducements ever be calibrated closely and accurately enough to replace, through monitoring and compensation systems, the foregone benefits of reciprocity? In all but the most nar-

mechanisms for capital allocation may help explain these differences in efficiency. The relative dominance of financial markets in the United States makes the consequences and costs of business decisions widely visible in starkly quantified form, enabling investors to draw comparisons among corporations, while investor-controlled transactions like hostile takeovers would prompt restructurings in less efficiently managed firms. Financial reporting standards in the United States are, by contrast with counterparts elsewhere, more exacting and less indulgent of managerial choice among accounting approaches. See Louis Lowenstein, *Financial Transparency and Corporate Governance: You Manage What You Measure*, 96 COLUM. L. REV. 1335, 1339-50 (1996).

⁷⁷ Marleen A. O'Connor, *Promoting Economic Justice in Plant Closings: Exploring the Fiduciary/Contract Law Distinction to Enforce Implicit Employment Agreements*, in *PROGRESSIVE CORPORATE LAW*, *supra* note 4, at 219, 221-22.

⁷⁸ *Id.* at 219.

⁷⁹ *Id.* at 219-20.

⁸⁰ *Id.* at 220.

⁸¹ *Id.*

⁸² Millon, *supra* note 61, at 1, 21.

⁸³ O'Connor, *supra* note 77, at 219, 220.

⁸⁴ *Id.*

rowly constrained work, employees make numerous discretionary decisions in the course of a day's work.⁸⁵ No monitoring system is ever a full substitute for employee good will and commitment to the success of the employer's enterprise. Compensation systems that peg an individual's remuneration to the results of monitoring her work-quality in turn have deficiencies derivative of the limitations implicit in monitoring.⁸⁶ Monitoring and other organizational control systems are themselves not free; to design and administer them carries costs that may exceed the costs of promoting trustworthy and cooperative behavior.⁸⁷

Many downsizings may represent an unsatisfactory resolution of the underlying tension between organizational interests, as perceived by senior management, and interests of community. The proper role for corporate law in directing or prompting a different resolution of the tension remains unresolved. In the high-trust societies described in Fukuyama's book, trust-based norms of reciprocity are deeply grounded in pervasive cultural patterns, to such a degree that formal law seems either irrelevant or antithetical. Theorists in the contractalist tradition might well argue that legal intervention is unnecessary because managers have an incentive not to downsize unwisely: managers will not downsize without a good reason to think substantial benefits will follow, because the corporation's reputation as an employer would be adversely affected otherwise. The operation of this constraint would be difficult to measure and, in any event, would not be significant if many similarly-situated employers are all engaged in downsizing. Furthermore, senior management often protects itself through express contract against personal consequences of losing control of the corporation. The popularity of golden parachutes and indemnification agreements, along with historically high levels of remuneration paid to senior management, would reduce the bite of the reputational risk as a constraint.⁸⁸

Two divergent directions for corporate-law reform suggest themselves. The first focuses on explanations for failed downsizings. Busi-

⁸⁵ EILEEN C. SHAPIRO, *FAD SURFING IN THE BOARDROOM: RECLAIMING THE COURAGE TO MANAGE IN THE AGE OF INSTANT ANSWERS* 86 (1995).

⁸⁶ Even stock-based compensation structures need a peg to determine how much stock (or its equivalent) should be allocated to each employee.

⁸⁷ W.E. Douglas Creed & Raymond E. Miles, *A Conceptual Framework Linking Organizational Forms, Managerial Philosophies, and the Opportunity Cost of Controls*, in *TRUST IN ORGANIZATIONS: FRONTIERS OF THEORY AND RESEARCH*, *supra* note 27, at 16, 27.

⁸⁸ Contemporary patterns of management remuneration raise two additional sets of issues. First, absolute levels of pay that impress most people as excessive may have detrimental side-effects on lower-ranked employees and on societal attitudes toward business. Second, if a pay structure does not vary sufficiently with the firm's performance, it may fail adequately to align top managers' incentives with shareholders' interests. For a comprehensive treatment, see CHEFFINS, *supra* note 18, at 654-72.

ness commentators suggest that many downsizings reflect indiscriminate reductions in payroll costs that unwisely cut talented and productive employees along with their less valuable colleagues.⁸⁹ Often in the wake of downsizings, corporations substantially increase their use of consultants and independent contractors to do work of erstwhile employees, a move that only substitutes variable for fixed costs.⁹⁰ External business consultants reportedly take the place in many instances of mid-level managerial employees and professional staff engaged in longer-term strategic activity. This substitution of externally-designed strategy for the more home-grown variety may result in lack of accountability for the strategy's consequences.⁹¹ A broader point is the long-term accountability of senior management and directors for the consequences of downsizing. In particular, corporate law reform might well focus on contractual structures and remuneration patterns that insulate senior management from the consequences of a failed downsizing.

A much more aggressive strategy to reform corporate law would entail changes in its precontractual specification of entitlements. Margaret Blair argues in her recent book *Ownership and Control* that policy should focus on identifying corporate governance structures most conducive to wealth creation, in Blair's view those that encourage employees to invest in "special skills or organizational capabilities."⁹² Investments in human capital are likely most important in technology-intensive or service-oriented businesses, "where most of the value added comes from innovation, product customization, or specialized services."⁹³ Employees of such businesses bear some of the risk associated with them, making employees stakeholders who are comparable to equity investors.⁹⁴ As a consequence, Blair advocates a restructuring of senior management's and directors' duties toward "maximizing the total wealth-creating potential of the enterprises they direct," taking into account the effect of important corporate decisions on all parties who have at-risk investments highly specialized to that corporation,⁹⁵ and recognizing that investment through equity-based compensation structures.

One difficult question raised by Blair's argument is whether reform in the fundamentals of corporate law is requisite to achieving her solution. At present many technology-intensive and service busi-

⁸⁹ See SHAPIRO, *supra* note 85, at 199-203.

⁹⁰ See *id.* at 210-11.

⁹¹ *Id.*

⁹² MARGARET M. BLAIR, *OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY* 339 (1995).

⁹³ *Id.* at 238.

⁹⁴ *Id.*

⁹⁵ *Id.* at 238-39.

nesses reward valued employees with formal ownership interests. High-technology start-ups⁹⁶ and law firms are well-known examples.⁹⁷ Employers who compete for employees of comparable talent, but who do not offer the rewards of equity ownership, would presumably suffer unless they offer other attractions.⁹⁸ Blair's proposal, in short, would accelerate and make more widespread the adoption of compensation structures already used by some employers, but would sacrifice the flexibility present in the status quo. In its present generalized form, her proposal bypasses the difficulties of measuring employees' differential contributions to a firm's success, allocating each an appropriate equity share and calculating the amount to be subtracted to reflect the value of cash compensation the employee has received. Likewise, Blair's proposal does not explore differences between the types of residual risk borne by employees as opposed to shareholders. Virtually all employees work under express or implied-in-fact contracts that entitle them to receive an amount of noncontingent cash compensation, on a current or deferred basis, in exchange for their work;⁹⁹ holders of common shares, in contrast, receive no comparable entitlements in exchange for investing. A virtue of the status quo is that it leaves to private bargains the terms under which, for any particular

⁹⁶ See, e.g., Joseph Bankman, *The Structure of Silicon Valley Start-Ups*, 41 UCLA L. REV. 1737 (1994).

⁹⁷ See, e.g., MARC GALANTER & THOMAS PALAY, *TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM* (1991).

⁹⁸ Start-up and spin-off companies frequently use stock options to attract and retain technical and managerial employees while paying them below-market salaries; larger established employers, in contrast, appear to structure compensation packages that use larger amounts of cash salary. See, e.g., Judith Messina, *Cyber Whiz Kids Exercising Options*, CRAIN'S N.Y. BUS., May 13, 1996, at 1, 37 (reporting that stock options are heavily used by small new-media companies to compete with larger firms for technical talent). High-technology firms (especially small ones) are heavy users of stock options throughout the workforce. *Employee Stock Options: Hearing Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing & Urban Affairs*, 103rd Cong., 1st Sess. 163, 165 (1993) (statement of Carolyn Ayer) (reporting that a 1991 study of high technology firms found 89% of employers with fewer than 100 employees award stock options to all employees while 35% of all employers award stock options to all employees).

Broader aggregate data measuring employee compensation do not include stock option plans. In contrast to selected employers' use of stock option plans, discussed above, employee stock ownership plans are much less prevalent in private industry as a whole. U.S. BUREAU OF THE CENSUS, *STATISTICAL ABSTRACT OF THE UNITED STATES* 438 tbl. 685 (1995) (reporting that in 1992-93, 3% of medium and large employers had employee stock ownership plans, in contrast to 1% of small private establishments, defined as those with fewer than 100 employees).

⁹⁹ In private industry, as of March 1994, wages and salaries constituted 71.1% of employer costs for employee compensation. BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, *EMPLOYMENT COST INDEXES AND LEVELS, 1975-94*, at 10-11 (1994). In earlier years, non-wage benefits constituted a smaller percentage of compensation costs. *Id.* at 10 (in March 1987, benefits made up 26.8%).

firm, these differential types of risk should be equated.¹⁰⁰ Finally, Blair's proposal treats equity ownership of a corporation as if it were free or unlimited. Of course it is neither; if the law mandated that a corporation allocate significant ownership shares to selected employees, the ownership interest of nonemployee shareholders would suffer proportionate dilution. The cost of the dilution could be offset only if employees' ownership of equity generated compensating gains. If not, inducing or retaining equity investment from nonemployee shareholders would require a higher return to offset the cost of dilution.

A larger question about legal intervention against downsizing (and proposals like Blair's, for that matter) is their effectiveness over time, given that capital and goods at present move relatively freely around the world. As John Parkinson concluded in a similar context, unilateral legal intervention would be vulnerable: "any changes designed to increase corporate social responsiveness that are liable to add significantly to companies' costs cannot in an increasingly global marketplace be safely introduced in one country."¹⁰¹ Many corporations, of course, have revenue streams that give management considerable ability to absorb additional costs imposed by new legal constraints. Beyond that point, however, Parkinson's conclusion is irresistible. Moreover, the trust-based argument for legal intervention against phenomena like downsizing does not explore how the gains to be created through enhanced reciprocity might be quantified, or even how they might compare with the costs of decreased managerial flexibility.¹⁰² This failure dooms the argument to rejection by those who can quantify with precision the advantages of the status quo.¹⁰³ Blair's proposal, likewise, mandates an equity share for selected employees without demonstrating that concrete benefits would follow or that the

¹⁰⁰ Some of the consequences of significant equity ownership by employees may help explain why employee-owned firms are relatively rare outside certain niches. It is arguable that the management function in worker-owned firms is inherently problematic. See CHEFFINS, *supra* note 18, at 561-63. As shareholders, moreover, many employees may rationally prefer short-term benefits over projects that maximize the firm's net cash flow over the longer term. *Id.* at 564-65. When employees become significant holders of equity in the status quo, one could infer that such issues are not pressing ones for a particular firm, or that the alternatives to employee ownership are so unattractive that solutions emerge.

¹⁰¹ J.E. PARKINSON, *CORPORATE POWER AND RESPONSIBILITY: ISSUES IN THE THEORY OF COMPANY LAW* 433 (1993).

¹⁰² Characterized a bit differently, a corporation structured by a pervasive norm of trust would result in a workplace that is, from the employer's standpoint, "high-cost" (versus "low cost") and, from the employees' perspective "high-effort" (versus "low effort"). See CHEFFINS, *supra* note 18, at 578-79. It is open to question whether high-cost, high-effort, organization necessarily produces a firm with a competitive advantage. *Id.* at 583-86.

¹⁰³ See COLEMAN, *supra* note 14, at 305 (acknowledging that it "remains to be seen" whether social capital will be as useful a quantitative concept in social science as are concepts of physical, financial and human capital).

anticipated value of those benefits would be persuasive to nonemployee shareholders.

In trust-based arguments, a great deal turns on the definition of membership in the group to be protected. Writers in this tradition, that is, tend to focus on the position of full-time, long-term employees but not on seasonal and part-time workers, independent contractors, or dependent suppliers of components. Translated into legal and regulatory norms, this pattern of exclusion clearly creates incentives for employers to reduce costs and enhance flexibility by satisfying needs for labor through sources other than full-time employees.¹⁰⁴

Finally, many theorists on all sides of this debate have not fully addressed the implications of the current demographics of shareownership. As of 1993, private employer pension funds held 22% of the total domestic equity market, and public sector pension funds held 9.3%.¹⁰⁵ If pension fund trustees and the fund managers who report to them highly value the increase in share prices produced by announced downsizing, recent developments would represent in aggregate a tradeoff of current compensation in favor of deferred compensation through increased pension payments for employees. The contractualist perspective invites reflection on whether this tradeoff reflects a bargain that private sector employees as a group might sensibly make; that is, to accept a higher risk of unemployment and cessation of income from salary for themselves individually and members of their family in exchange for a larger or more secure prospect of pension-generated income in old age. Such a bargain might be more sensible for highly compensated employees with readily-transferable skills than for lower paid and less mobile employees. Downsize-driven gains are, additionally, of little comfort to laid-off employees without vested entitlements to pensions.

II

THE ROLE OF LAW IN THEORIES OF CORPORATE LAW

In the literature discussed in this Essay, the deepest lines of intellectual demarcation concern the nature and function of law. Abstract

¹⁰⁴ In contrast, under present law the incentive effects are less clear. Consider the differences between the status of an employee-at-will and the status of an independent contractor who provides a service. In most jurisdictions, employees-at-will may be terminated for any reason or for no reason unless the termination contravenes public policy. In sharp contrast, to terminate the independent contractor requires showing that it has breached its contract. Even in the absence of an express contract, an independent contractor may be able to recover costs it has incurred in reliance on its relationship with the other party, costs that are not generally recoverable in an employment context. Scott E. Masten, *A Legal Basis for the Firm*, in *THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT* 196, 205-06 (Oliver E. Williamson & Sidney G. Winter eds., 1991).

¹⁰⁵ See ROE, *supra* note 3, at 125.

though the underlying question may seem, much of practical import follows from the answers. Consider first whether organizational features warrant independent recognition within a theory of corporate law or whether, as in the "nexus of contracts" corporation, corporate law simply "adopt[s] a background term that prevails unless varied by contract."¹⁰⁶ That corporate law also provides formal structure for an organization, a construct separate in many respects from its varied participants, is not itself of interest. The "nexus of contracts" view postulates that the content of the background term provided by corporate law would be the provision to emerge in bargaining, were there no impediments to striking a bargain or transaction costs in doing so. Theory grounded in the "nexus of contracts" view would treat questions about choices among organizational structures as susceptible of investor choice within a menu of investment opportunities and thus of market-generated pricing through which investor preference could be quantified.¹⁰⁷

Critics of contractualism argue that this view disregards much of intellectual and practical significance. For one thing, its net import is to legitimate the current range of management power and discretion.¹⁰⁸ Contractualism, that is, enables every critique of corporate governance to be answered with the rejoinder that if shareholders were truly willing to pay for other arrangements, the market would provide them. Additionally, basic aspects of corporate law grounded in the law of agency elude capture by contractualist models. How does contract explain the corporation's vicarious liability for certain of its employees' torts? Or imputation to the corporation of information obtained by its agents? Or the differentiation drawn by corporate law between directors, who are elected by shareholders, and officers, who are agents appointed by directors? Contractualism's oversights can be stated in broader terms. Gunther Teubner notes that contractualist accounts omit many aspects of formal organization, including participants' goal-orientation and orientation to organizational

¹⁰⁶ EASTERBROOK & FISCHER, *supra* note 15, at 36.

¹⁰⁷ See *id.* at 17. Contractualism may embody a vision of contract law that is out of sync with empirically-grounded understandings of the importance and operation of contract law in long-term business relationships. See generally Jean Braucher, *Contract Versus Contractarianism: The Regulatory Role of Contract Law*, 47 WASH. & LEE L. REV. 697, 709-12 (1990) (defining the relational paradigm of contract as a response to the inadequacies of a paradigm of contracts as discrete transactions). Within such scholarship, the significance of contract itself in shaping expectations is actively in dispute. See, e.g., Stewart Macaulay, *Organic Transactions: Contract, Frank Lloyd Wright and the Johnson Building*, 1996 WIS. L. REV. 75, 76-77. Contractualism may presuppose a sharper degree of definition and fixity in contractual obligation than is observable in many long-term business relationships, as well as positing that parties once in a relationship are always free to resort to self-interested hard bargaining as opposed to a commitment to maintain the relationship. *Id.* at 111.

¹⁰⁸ See PARKINSON, *supra* note 101, at 189.

norms, informal relationships within the organization, as well as the significance of the corporation itself as a profit-maximizing contracting entity.¹⁰⁹ Accounts that slight the significance of cooperation as a basic mode of human interaction ignore or underplay aspects of corporate law that enable organizations to operate and, more generally, the mechanisms, both subtle and obvious, that permit organizations to be self-reflective. Robert Flannigan's critique of contractualism chides its proponents for dismissing the significance of the firm's power to direct human capital.¹¹⁰ Employees, writes Flannigan, "do not refuse to accept direction. They do what is asked of them, and they do so for very good reasons."¹¹¹ The facts of control and authority within a functional firm, that is, create an organizational structure that supersedes the prospect of moment-by-moment contracting between the firm and each employee.¹¹²

In contrast, Joseph Vining's broader account of the function of corporate law more accurately encompasses its functional and normative range. Vining identifies three separate strands within the functions served by corporate law: first, allocating power over the use of material resources and the terms of work; second, allocating and real-locating wealth, loss, and the risk of loss; and third, designating authority to carry on and maintain organized activity.¹¹³ Vining's formulation, albeit abstract, provides the framework for a richer and more comprehensive treatment of corporate law's scope and significance. It acknowledges that corporate law has consequences for third parties who are not parties to even a hypothetical bargain with those in control of corporate actors, while encouraging inquiry into formal and informal processes internal to corporations that facilitate or impede their functioning.

A closely related dispute concerns the impact of contractualist characterization on selected doctrines of corporate law, in particular the fiduciary duty-of-loyalty directors and officers owe the corporation

¹⁰⁹ See TEUBNER, *supra* note 19, at 129-31. Even contractualist accounts may be unable to avoid ascribing normative significance to the parties' association. In describing how to apply the hypothetical bargaining model, with its focus on "specific relationships which exist between particular company participants," Brian Cheffins writes that one ascertains how those parties would have dealt with certain issues had they turned to them while negotiating, a process that requires "stepping into the parties' shoes to make sense of their project." CHEFFINS, *supra* note 18, at 264. This passage presupposes that the parties together indeed have a "project" with an identity ascertainable by an external observer. That a "project" exists and that it is "theirs" tends to imply that participants in the relationship should cooperate toward reaching a mutual end.

¹¹⁰ Flannigan, *supra* note 19, at 119.

¹¹¹ *Id.* Employees take direction because they are uninterested in incurring the costs requisite to finding new employment "simply to demonstrate their ultimate personal autonomy." *Id.* at 119 n.48.

¹¹² *Id.* at 119-20.

¹¹³ See JOSEPH VINING, FROM NEWTON'S SLEEP 319 (1995).

and its shareholders. The duty prohibits directors and officers from using "their position of trust and confidence to further their private interests. . . . The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest."¹¹⁴ Self-dealing transactions between a director or officer and the corporation itself are prototypical examples of conduct that may contravene the duty. William Bratton's contribution to *Progressive Corporate Law* argues that contractualism unwisely removes any normative disapproval of self-interested conduct by fiduciaries.¹¹⁵ The model of human interaction that underlies contractualism is unduly simplistic, according to Bratton, because it, by recognizing only self-interest as a motivation, cannot explain the occurrence of the coordination necessary to production in firms.¹¹⁶ In Bratton's account, premised on game theory, voluntary interaction for gain can and does proceed absent a contract in a stabilizing atmosphere of trust, which enables the occurrence of all sorts of cooperative activity. Within corporate law, fiduciary obligation bolsters investors' trust in directors and managers; its rhetoric and content, additionally, are components of trust because they dictate self-disregard by the fiduciary.¹¹⁷

To be sure, contemporary corporate law itself has dimensions that diffuse the psychological phenomenon of trusting behavior into legal norms that, first, reflect the influence of contract and, second, orient judicial review away from the substantive merit of self-dealing transactions and toward the corporation's internal process that approved the transaction. In particular, provisions added in the late 1980s to the Revised Model Business Corporation Act create procedural rules that, if followed, insulate from substantive judicial review decisions of corporate directors regarding self-dealing transactions.¹¹⁸ This shift to process-driven insulation of self-dealing is credible only if directors' decisions are themselves credible in this context. As Bratton characterizes matters at present, a "preference for self-regulation coexists uneasily with continued skepticism about the integrity of the processes under review."¹¹⁹ Much case law illustrates the manipulability of internal corporate processes for decisionmaking at the behest of those benefitted by the decision.¹²⁰

¹¹⁴ Guth v. Loft, 5 A.2d 503, 510 (Del. Ch. 1939).

¹¹⁵ William W. Bratton, *Game Theory and the Restoration of Honor to Corporate Law's Duty of Loyalty*, in *PROGRESSIVE CORPORATE LAW*, *supra* note 4, at 139, 152. *Accord*, CHEFFINS, *supra* note 18, at 141-42.

¹¹⁶ CHEFFINS, *supra* note 18, at 154, 160.

¹¹⁷ *Id.* at 165-68.

¹¹⁸ MODEL BUSINESS CORP. ACT §§ 8.60-63 (1993).

¹¹⁹ Bratton, *supra* note 115, at 140.

¹²⁰ For a judge's assessment of such scenarios, see William T. Allen, *Independent Directors in MBO Transactions: Are They Fact or Fantasy?*, 45 BUS. LAW. 2055 (1990).

Lawrence Mitchell's contribution to *Progressive Corporate Law* critiques these developments on grounds more basic than skepticism about process. Mitchell argues that procedure and contract are parasitic on trust in order to function but, paradoxically, as their spheres expand, they "begin to strangle trust and, perhaps, destroy it."¹²¹ Rules that permit self-dealing by corporate directors and officers are destructive of trust because, at best, they restrict opportunistic conduct to the margins. The incursion of contract law that these rules represent undercuts the point of fiduciary duty because it limits duty to the letter of the bargain, and thereby legitimates for fiduciaries a perspective that looks first to their own interests to determine whether to pay particular regard to the interests of others.¹²² Mitchell's critique does not acknowledge that self-dealing with consent has long been an established facet of other bodies of fiduciary doctrine, such as agency¹²³ and trust law.¹²⁴ Self-dealing on the corporate front is qualitatively different, however, because only in a very small corporation would stockholders be in a position to negotiate with directors over the terms of a specific self-dealing transaction.¹²⁵ Contemporary corporation statutes contemplate that directors may consent to the self-dealing of their fellow directors and thereby bind shareholders.¹²⁶ In contrast, under trust or agency law, the relevant consent is directly that of the beneficiary of the fiduciary relationship, and the beneficiary is situated to negotiate the terms of the transaction, as opposed to simply rejecting or accepting it.¹²⁷ Technicalities aside, Mitchell's larger point is that trust is fragile. Encrustations of process to permit self-serving conduct burden trust unduly.¹²⁸ When the process is itself vulnerable to manipulation by its self-interested beneficiaries, only a desiccated formality, but not trust, survives.¹²⁹

¹²¹ Lawrence E. Mitchell, *Trust, Contract, Process*, in *PROGRESSIVE CORPORATE LAW*, *supra* note 4, at 185, 187.

¹²² *Id.* at 209.

¹²³ See RESTATEMENT (SECOND) OF AGENCY § 389 (1958).

¹²⁴ See RESTATEMENT (THIRD) OF TRUSTS § 170 (1990).

¹²⁵ See Harold Marsh, Jr., *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 BUS. LAW. 35, 49 (1966).

¹²⁶ See, e.g., DEL. CODE ANN. tit. 8, § 144 (1995). Interestingly, not all contemporary corporation statutes contain comparable provisions. In Britain, provisions in the Companies Act 1985 require shareholder approval for self-dealing transactions between a director and a corporation that involve noncash assets above a prescribed level. See CHEFFINS, *supra* note 18, at 144 (discussing sections 320, 322(2)(c) & 322A(5)(d) of Companies Act 1985).

¹²⁷ RESTATEMENT (SECOND) OF AGENCY § 390 (1958); RESTATEMENT (THIRD) OF TRUSTS § 170 (1990).

¹²⁸ Mitchell, *supra* note 121, at 187.

¹²⁹ *Id.* at 209.

CONCLUSION

The current vigor of scholarly writing about corporate law bodes well for its future. Two characteristics of the recent literature are noteworthy in connection with the field's promise of continuing vitality. First, the introduction of perspectives grounded in nonlegal academic disciplines has demonstrably invigorated discussion and deepened analysis. It has also served to legitimate the field to academic colleagues skeptical of the field as an unremittingly mundane or cut-and-dried endeavor.¹³⁰ Second, recent literature eagerly embraces as topics for study all manner of current developments in business and financial practice. That current practice intrigues theoretically-oriented academics helps ensure that corporate legal scholarship will not run dry. General optimism aside, the future contours of corporate legal theory are imponderable. For starters, ongoing evolution in business forms and structures may call into question the central importance of the discrete firm as the dominant focus for analysis. For many reasons, carrying on business through a disaggregated enterprise can be attractive. Disaggregation in all its forms reduces capital and other costs and diffuses risk. Franchising, an established example of disaggregated enterprise, formally separates into many separate "firms" what is in numerous respects a common business activity. Many corporations, for that matter, increasingly outsource to obtain parts necessary for the finished product, disaggregating into separate firms the production of physical components and the provision of labor. Asset securitization transactions effect a more permanent form of disaggregation; the corporation sells ownership of cash-generating assets, like accounts receivable, to a separate corporate vehicle that in turn issues and sells debt securities into public capital markets. Asset securitization effectively disaggregates financial assets from the corporation (and its business risks) that produced them.¹³¹ Finally, current business practice contains examples of centrally-coordinated activity that, for one reason or another, does not lead to formation of a discrete firm. The increased popularity of strategic alliances among firms to create networks in pursuit of some

¹³⁰ Cf. Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 923, 1015 (1984) (characterizing the previous condition of the field as "uninspiring . . . for research even to some of its most astute students" and attributing the field's scholarly renaissance to development of financial economics as a research tool).

¹³¹ The economic point of asset securitization is to reduce the overall cost of capital borne by the corporation that sells its cash-generating assets. The purchasing corporation, separate as it is from business risks of the selling corporation, would have a higher credit rating, and be able to sell its debt securities at a lower interest rate, than would the selling corporation. Nor do the borrowing costs of the selling corporation increase proportionately after the asset securitization transaction. See Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133 (1994).

shared business-interest layers an informal organizational device, the network, over firms that remain separate organizations in other respects.¹³²

Disaggregation in all its forms is a significant business phenomenon raising numerous legal issues that lie outside the present grasp of corporate legal theory. The contractualist literature predicts that persons engaged in a particular economic activity will form a firm when the costs of coordination within an integrated firm are less than those entailed by carrying on the activity through market transactions and discrete contracts with providers of inputs.¹³³ Although helpful as a starting point, this explanation does not itself address the legal consequences of disaggregated but centrally organized activities like networks. Nor does it reflect the varied consequences of disaggregating work done by employees for a firm into a contractually-defined matrix of independent contractors.¹³⁴

Likewise eluding the grasp of much corporate theory, multinational corporations transcend national and, in some respects, normative boundaries. Questions of ownership, accountability, and control are vexing in a corporation that has more than one national "home." Eric Orts's contribution to *Progressive Corporate Law* notes that by 1990, about half of gross global product was traceable to international production and international trade.¹³⁵ Multinational corporations themselves hold at least \$6 trillion in foreign assets.¹³⁶ Given relatively free economic movement among nations, businesses are increasingly able to practice regulatory arbitrage; holding companies, subsidiary struc-

¹³² See Steven R. Salbu, *The Decline of Contract as a Relationship Management Form*, 47 RUTGERS L. REV. 1271, 1276 n.18 (1995).

¹³³ The starting point is, of course, Ronald H. Coase, *The Nature of the Firm*, 14 ECONOMICA 383 (1937), reprinted in *THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT*, *supra* note 104, at 18, 21. In later reflections, Coase acknowledged the practical difficulties of measuring and assessing the impact of transactions costs, many of them interrelated. Ronald H. Coase, *The Nature of the Firm: Influence*, in *THE NATURE OF THE FIRM: ORIGINS, EVOLUTIONS, AND DEVELOPMENT*, *supra* note 104, at 61, 63. He also emphasizes that the emergence of a firm substitutes intra-firm transactions for transactions among separate factors, as well as substituting firm-consumer for factor-consumer transactions. *Id.* at 66.

¹³⁴ Regulatory attention has recently focused on risks of miscommunication created by airlines' practice of using nonemployee independent contractors to perform aircraft maintenance work previously done by employees. Adam Bryant, *F.A.A. Struggles As Airlines Turn to Subcontracts*, N.Y. TIMES, June 2, 1996, at 1, 26. It is especially attractive for an airline to be able to outsource maintenance at airport locations where it has few flights. *Id.* at 26. But few airlines operate exactly the same way, making it crucial that the airline monitor outside contractors very carefully. *Id.* It is unusual for an airline to use more than two or three outside maintenance firms because the equipment is complicated and maintaining it is a communication-intensive activity. *Airlines' Use of Outside Maintenance Is Expected to Grow*, WALL ST. J., June 19, 1996, at B4.

¹³⁵ Eric W. Orts, *The Legitimacy of Multinational Corporations*, in *PROGRESSIVE CORPORATE LAW*, *supra* note 4, at 247, 248.

¹³⁶ *Id.*

tures, and disaggregation in other forms enable businesses to transcend inhibitory elements of particular bodies of corporate law.¹³⁷ The solutions to regulatory arbitrage are, however, likely to be products of institutions of public international law like multilateral treaties and international regulatory bodies, which are not within the conventional cast of characters in corporate legal theory.

The work discussed in this Essay reflects the invigorating effect of incorporating insights afforded by other intellectual disciplines into legal scholarship. The introduction of insights grounded in microeconomic analysis has enhanced the intellectual rigor of corporate legal scholarship. The complexity of the behavior and organizations to which corporate law lends formal legal structure belies the explanatory force of any one intellectual discipline, however. Moreover, many business environments are now less stable than heretofore, at least by post-World War II standards; many firms, although smaller due to disaggregation, confront as a consequence new challenges of controlling and coordinating the activity of nonemployees. Additional disciplines—game theory and social psychology prominent among them—are likely to enter scholars' analytic inventory and vocabulary. As a result, although the theoretical future might look less tidy¹³⁸ than some would wish, its longevity will be enhanced. In short, like a shark, corporate law scholarship requires motion for its survival.

¹³⁷ See generally PHILLIP I. BLUMBERG, *THE MULTINATIONAL CHALLENGE TO CORPORATION LAW: THE SEARCH FOR A NEW CORPORATE PERSONALITY* (1993) (examining the emerging enterprise law that is changing traditional corporation theory and the challenge to national legal systems presented by multinational corporate groups).

¹³⁸ The distinguished social scientist Jon Elster writes pessimistically about prospects for greater intellectual tidiness in social science. At present, he observes, "the social sciences cannot aspire to be more than social chemistry: inductive generalizations that stick closely to the phenomena." JON ELSTER, *THE CEMENT OF SOCIETY: A STUDY OF SOCIAL ORDER 1* (1989). The time for "social physics" has not arrived, according to Elster. *Id.* Physics, a parsimonious discipline, deploys a few basic ideas of universal validity that through their logical interconnections capture much factual information. *Id.* at 1 n.1. Chemistry lacks the simple predictive principles of physics; chemists "are marvelous in their ability to hold in their heads at all times a vast array of information." *Id.*